

not be characterized as a lease for purposes of section 168(f)(8) unless the qualified lessor has a minimum at risk investment which, at the time the property is placed in service under the lease and at all times during the term of the lease, is not less than 10 percent of the adjusted basis of the leased property. As the adjusted basis of the leased property is reduced by capital cost recovery deductions, the minimum investment required will also be reduced to 10 percent of the revised adjusted basis, until the adjusted basis has been completely recovered, at which time no minimum investment will be required. Financing provided by the lessee or a party related to the lessee, such as a recourse note given by the lessor to the lessee, will not be taken into account in determining the lessor's minimum investment.

(b) *At risk amount.* The minimum investment which the lessor has at risk with respect to the leased property for purposes of paragraph (a) of this section includes only consideration paid and recourse indebtedness incurred by the lessor to purchase the property. The lessor must have sufficient net worth (without regard to the value of any leases which qualify under section 168(f)(8)) to satisfy any personal liability incurred. Any tax benefits which the lessor derives from the leased property shall not be taken into account to reduce the amount the lessor has at risk. An agreement between the lessor and the lessee requiring either or both parties to purchase or sell the qualified leased property at some price (whether or not fixed in the agreement) at the end of the lease term shall not affect the amount the lessor has at risk with respect to the property. However, an option held by the lessor to sell the property that is exercisable before the end of the period prescribed under section 168(c)(2) for the recovery property class of the leased property (taking into account any election by the lessor or lessee under section 168(b)(3)) shall reduce the amount the lessor is considered to have at risk by the amount of the option price at the time the option becomes exercisable.

§ 5c.168(f)(8)-5 Term of lease.

(a) *Term of lease—Basic rules.* To qualify as a lease under section 168(f)(8) and § 5c.168 (f)(8)-1 (a), the lease agreement must provide for a term that does not exceed the maximum term described in paragraph (b) of this section; such term must also at least equal the minimum term described in paragraph (c).

(b) *Maximum term.* For purposes of section 168(f)(8)(B)(iii) and this section, the term of the lease may not exceed the greater of—

(1) 90 percent of the useful life of the property under section 167, or

(2) 150 percent of the asset depreciation range (ADR) present class life ("midpoint") of such property, applicable as of January 1, 1981 (without regard to section 167(m)(4)), published in Rev. Proc. 77-10, 1977-1 C. B. 548, and revisions thereto.

Solely for purposes of this paragraph (b), "useful life" means the period when the leased asset can reasonably be expected to be economically useful in anyone's trade or business; such term does not mean the period during which the lessor expects to lease the property. Any option to extend the term of the lease, whether or not at fair market value rent, must be included in the term of the lease for purposes of this paragraph. If several different pieces of property are the subject of a single lease, the maximum allowable term for such lease will be measured with respect to the property with the shortest life. In no case, however, will the lease term qualify under this section if such term with respect to any piece of property is less than the minimum term described in paragraph (c).

(c) *Minimum term.* For purposes of this section, the term of the lease must at least equal the period prescribed under section 168(c)(2) for the recovery property class of the leased property. For example, if a piece of leased equipment is in the 5-year recovery property class, the lease agreement must have a minimum term of 5 years. In general, the determination of whether property is 3-year recovery property, 5-year recovery property, etc., in the hands of the lessor will be based on the characterization of the property in the hands of the owner as determined without regard to the section 168(f)(8) lease. Thus,

for example, property which is public utility property or RRB replacement property absent the section 168(f)(8) lease will be characterized as such in the hands of the lessor for purposes of section 168(f)(8). However, with respect to RRB replacement property, the transitional rule of section 168(f)(3) shall be inapplicable to the lessor. In addition, any election under section 168(b)(3) by the lessor with respect to the class of recovery property to which the qualified leased property is assigned shall apply to the leased property in determining the term of the lease. A lease term that does not exceed the term required to satisfy the minimum lease term of this paragraph will be deemed to comply with the maximum lease term described in paragraph (b) if such minimum lease term exceeds such maximum lease term.

(d) *Examples.* The application of this section may be illustrated by the following examples:

Example (1). X Corp. (as lessee) and Y Corp. (as lessor) enter into a lease which they elect to be treated under section 168(f)(8) with respect to a chemical manufacturing facility that will also generate steam for use in the production of electricity. The assets comprising the chemical plant are described in ADR guideline class 28.0 (midpoint life of 9.5 years), and the assets comprising the steam plant are described in ADR class 00.4 (midpoint life of 22 years). To satisfy the maximum lease term requirement of section 168(f)(8)(B)(iii)(II) and §5c.168 (f)(8)–5(b), the lease term may not exceed 14.25 years (150 percent of the 9.5 year midpoint life of the chemical plant).

Example (2). The facts are the same as in example (1) except that the chemical plant and the steam plant are the subject of separate leases. For purposes of section 168(f)(8)(B)(iii)(II) and §5c.168(f)(8)–5 (b), the maximum term of the lease with respect to the chemical plant is 14.25 years (150 percent of 9.5 years) and the maximum term of the lease with respect to the steam plant is 33 years (150 percent of 22 years).

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§5c.168(f)(8)–6 Qualified leased property.

(a) *Basic rules—(1) In general.* An agreement shall be treated as a section 168(f)(8) lease only if the property which is leased is qualified leased property. Qualified leased property is re-

covery property as defined in section 168(c) and is either—

(i) Except as provided in subparagraph (2), new section 38 property of the lessor which is leased no later than 3 months after the date the property was placed in service (or prior to November 14, 1981, if the property was placed in service after December 31, 1980, and before August 14, 1981) and which, if acquired by the lessee, would have been new section 38 property of the lessee, or

(ii) Property which is a qualified mass commuting vehicle (as defined in section 103(b)(9)) and which is financed in whole or in part by proceeds from an issue of obligations the interest on which is excludable from income under section 103(a).

(2) *Sale and leaseback arrangement.* (i) Where the leased property is purchased, directly or indirectly, by the lessor from the lessee (or a party related to the lessee), the property will not be qualified leased property unless the property was (or would have been) new section 38 property of the lessee and was purchased and leased no later than 3 months after the date the property was placed in service by the lessee (or prior to November 14, 1981, if the property was placed in service by the lessee after December 31, 1980 and before August 14, 1981) and with respect to which the lessor's adjusted basis does not exceed the adjusted basis of the lessee (or a party related to the lessee) at the time of the lease. If the lessor's adjusted basis in the property exceeds the seller's adjusted basis with respect to the property at the beginning of the lease, the property will not be qualified leased property.

(ii) For purposes of this paragraph (a)(2) and paragraph (b)(3)(ii) of this section, transactional costs with respect to a sale and leaseback arrangement that are not currently deductible shall be allocated to the lease agreement (and not included in the lessor's adjusted basis with respect to the property) and amortized over the term of the lease. These costs include legal and investment banking fees and printing costs.

(iii) The application of this paragraph (a)(2) may be illustrated by the following examples: